

Message Text

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ACTION EUR-12

INFO OCT-01 AID-05 CIAE-00 COME-00 EB-08 FRB-03 INR-07
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TAGS: ECON, EFIN, ELAB, PINT, SP
SUBJECT: SPANISH GOVERNMENT DEBATING ECONOMIC MEASURES

REF: (A) MADRID 7107, (B) MADRID 7076

1. SUMMARY: THE SPANISH GOVERNMENT THROUGH A SERIES OF EXTRAORDINARY MEETINGS WILL DECIDE THIS WEEK ON SPECIFIC ECONOMIC MEASURES TO BE PRESENTED TO THE CORTES BEFORE OCTOBER 15. INDICATIONS THUS FAR ARE THAT THESE MEASURES WILL BE CONSISTENT WITH THE BROAD ECONOMIC PLAN WHICH THE GOVERNMENT UNVEILED IN JULY. IMPLEMENTATION OF THE MORE RESTRICTIVE (BUT LESS DIRECTED) MONETARY POLICY AND FINANCIAL REFORMS ENVISIONED IN THE PLAN HAS ALREADY BEGUN, AND SOME TAX MEASURES ARE BEFORE THE CORTES. HOWEVER, THE MEASURES SO FAR BROUGHT INTO EFFECT ARE NOT IN THEMSELVES ENOUGH TO STOP THE INFLATIONARY SPIRAL HERE, WAGE RESTRAINT IS NECESSARY. CHANGES IN SPAIN'S INEFFECTIVE PRICE CONTROLS ARE NOW BEING CONSIDERED A LEGISLATIVE BILL TO REFORM AND BROADEN DIRECT

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TAXATION WILL BE UNVEILED SOON. OTHER MEASURES WHICH THE CABINET MAY BE DISCUSSING NOW INCLUDE MORE FREEDOMS FOR ORGANIZED LABOR, ASSURANCE OF EMPLOYER FLEXIBILITY ON LEVELS OF PERSONNEL, AND ENERGY MEASURES. END SUMMARY.

2. EXPRESSIONS OF CONCERN OVER THE GOVERNMENT'S

ECONOMIC PROGRAM HAVE BEEN INCREASING RECENTLY, IN PART BECAUSE THE PROGRAM PINCHES BUT ALSO IN PART PERHAPS BECAUSE OF AN INSUFFICIENT PUBLIC RELATIONS EFFORT. PRIME MINISTER SUAREZ IS NOW FACED WITH THE QUESTION WHETHER HE WILL GET OUT IN FRONT TO FIGHT FOR THE PROGRAM. PRESENT INDICATIONS, ALTHOUGH NOT CERTAIN, ARE THAT HE WILL DO SO, IN AN APPEARANCE BEFORE THE CORTES WITHIN TWO OR THREE WEEKS. THE DETAILS OF HIS PRESENTATION AT THAT TIME ARE NOW BEING WORKED OUT.

3. THE PRINCIPAL ACTION TAKEN BY THE GOS SINCE THE JULY 12 PESETA DEVALUATION IS A SLOW REDUCTION, BEGINNING IN AUGUST, IN THE GROWTH RATE OF THE BROAD MONEY (M3) SUPPLY. THE CONSEQUENT REDUCTION IN THE CREDIT SUPPLY HAS BROUGHT FORTH CRIES OF PAIN AND MEETINGS WITH CREDITORS BY ADVERSELY AFFECTED BUSINESSMEN, WHO DISAGREE WITH THE ECONOMIC ESTABLISHMENT, PRIMARY WEAPON AGAINST SPANISH INFLATION. THE GOVERNMENT REMAINS COMMITTED TO THE PHILOSOPHY OF ITS JULY ECONOMIC PLAN, WHICH IS THAT A SLOWDOWN IN THE MONEY GROWTH IS ESSENTIAL BUT MUST BE ACCCOMPANIED BY OTHER MEASURES IF THE RUNAWAY INFLATION IS TO BE STOPPED. THE DEBATE ON THE CHOICE OF ANTI-INFLATION MEASURES CURRENTLY DOMINATES ECONOMIC POLICY DISCUSSIONS. STRUCTURAL REFORMS ARE ALSO RECEIVING CONSIDERABLE ATTENTION

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FROM ALL QUARTERS. THE LARGE BALANCE OF PAYMENTS DEFICIT IS NOW A LESS PRESSING PROBLEMS DUE TO THE POST-DEVALUATION REFLUX OF FOREIGN RESERVES AND THE IMPROVED CURRENT ACCOUNT SITUATION, AND IS TAKING A BACK SEAT TO INFLATION IN THE CURRENT ECONOMIC POLICY DEBATE.

4. BEYOND THE MONETARY TOOL, THE PRINCIPAL SHORT TERM ANTI- INFLATIONARY MEASURES INCLUDED IN THE JULY ECONOMIC PLAN ARE BUDGET AND WAGE RESTRAINT AND LIMITED PRICE CONTROLS. THE VARIOUS PRICE CONTROL MEASURES PUT INTO EFFECT SINCE 1973, INCLUDING THE TWO PRINCIPAL DECREE LAWS STILL IN FORCE, HAVE HAD VERY LITTLE SUCCESS AND EXPIRE ON THE LAST DAY OF SEPTEMBER. LAST FALL'S DECREE-LAW ATTEMPTING TO FIX MAXIMUM WAGE INCREASES IS SO MEANINGLESS THAT IT IS NO LONGER MENTIONED BY THE PRESS OR GOVERNMENT INSTEAD, THE GOVERNMENT IS ATTEMPTING TO PERSUADE LABOR THOUGH DIALOGUE AND, INDIRECTLY, THROUGH THE EFFECTS OF CREDIT RESTRAINT ON WAGE NEGOTIATIONS.

5. THE GOVERNMENT MAY DECIDE

THIS WEEK TO SEEK MORE EFFECTIVE, EVEN IF STILL LIMITED, PRICE CONTROLS AND FURTHER MEASURES TO ACHIEVE WAGE RESTRAINT. THE GOS MAY ABANDON ITS PRESENT BROAD BUT UNSUCCESSFUL PRICE CONTROL SYSTEM IN FAVOR OF STRICT ENFORCEMENT OF ADMINISTERED PRICES FOR 20 OR SO CONSUMER NECESSITIES (INCLUDING THE BREAD PRICE ON WHICH THE GOS STOOD FIRM THIS SUMMER AGAINST A NATIONAL BAKERS STRIKE). NEW ENFORCEMENT TOOLS MAY BE ANNOUNCED, AND THESE COULD INCLUDE JUDICIAL PUNISHMENTS AND THE SELECTIVE REDUCTION OF PROTECTIVE TARIFFS. IT IS DIFFICULT TO PREDICT WHAT GREATER EFFORTS AT WAGE RESTRAINT THE GOVERNMENT MAY ATTEMPT. THE GOVERNMENT HAS ALREADY SAID THAT LOWER PAID WORKERS SHOULD NOT SUFFER FROM ANY PROGRAM

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OF WAGE RESTRAINT, AND THIS DAILY MINIMUM WAGE HAS BEEN DULY RAISED TO PESETAS 500 (ALMOST U.S. \$6) EFFECTIVE OCTOBER 1 REFLECTING THE 13.6 PERCENT INCREASE IN COST OF LIVING OVER THE PAST SIX MONTHS. THE GOVERNMENT IS SAID TO BE CONSIDERING MAKING "EXCESSIVE" WAGE INCREASE NON TAX DEDUCTIBLE, AND AT THE SAME TIME, LOWERING JOB SECURITY FOR NEWLY-HIRED WORKERS.

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6. THE CHANGED MONETARY POLICY, THE WAGE PRICE MEASURES AND GOVERNMENT SPENDING RESTRAINT, TOGETHER WITH THE 20 PER CENT PESETA DEVALUATION, ARE THE HEART OF THE SHORT-TERM STABILIZATION PROGRAM. ALSO INCLUDED IN THE SHORT TERM PROGRAM ARE MEASURES TO REDUCE (HOPEFULLY) THE IMPACT OF UNEMPLOYMENT AND POSSIBLY NEW ENERGY MEASURES IN NOVEMBER. THE GOVERNMENT'S ECONOMIC PROGRAM, HOWEVER, INCLUDES ANOTHER CATEGORY OF MEDIUM TERM MEASURES AIMED AT SPAIN'S ABUNDANT STRUCTURAL PROBLEMS. THE MOST IMPORT OF THESE MEASURES ARE TAX REFORMS AND THE STRENGTHENING OF FINANCIAL AND COMMERCIAL MARKETS.

7. OF THESE STRUCTURAL REFORMS, THE ONE WHICH HAS ADVANCED MOST RAPIDLY HAS BEEN REFORM OF THE MONETARY SYSTEM (SEE MADRID 6715) WHICH PROBABLY WILL BE SUPPLEMENTED IN THE NEAR FUTURE BY LICENSES FOR MORE FOREIGN BANKS TO OPERATE HERE. HOWEVER, THE GOVERNMENT IS NOW COMPLETING WORK ON IMPORTANT PARTS OF ITS FISCAL REFORM.

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COMMITTEE CONSIDERATION IS ABOUT COMPLETE IN THE LOWER HOUSE OF THE LEGISLATURE ON AN INITIAL TAX PACKAGE. A LEGISLATIVE PROPOSAL FOR THE COMPLETE REFORM OS SPAIN'S DIRECT TAXATION SYSTEM (SEE MADRID 5632) IS EXPECTED THIS WEEK. A NEW , MORE COMPREHENSIVE AND "TRANSPARENT" BUDGET DOCUMENT (SEE MADRID 6143) WILL CONTRIBUTE TO KEEPING SPAIN'S FISCAL DEFICIT UNDER CONTROL AND SHOULD BE A MORE EFFECTIVE INSTRUMENT FOR TRANSFERRING RESOURCES TO PRIORITY NEEDS. INCLUDING EMPLOYMENT GENERATING PUBLIC WORKS. THE CY 1978 BUDGET PROPOSAL IS DUE IN THE CORTES ON OCTOBER 15, AND, NOTWITHSTANDING THE ENORMITY OF THE TASK, WE HAVE BEEN RECENTLY ASSURED BY GOS OFFICIALS THAT THE DEADLINE WILL BE MET. BY NOVEMBER 30 THE GOVERNMENT INTENDS TO DETAIL A PROGRAM TO REFORM INDIECT TAXATION, INCLUDING THE CASCADE AND SOCIAL SECURITY TAXES. ANOTHER IMPORTANT PART OF THE GOVERNMENT'S STRUCTURAL REFORM PROGRAM AND MOVE TOWARD A MARKET ECONOMY IS BEING ACHIEVED BY OMISSION: IN SPITE OF THE HIGH BALANCE OF PAYMENTS DEFICIT AND DEMANDS FROM INTEREST GROUPS, THE GOS HAS RESISTED HIGHER TARIFFS AND OTHER PROTECTIONIST MEASURES. IN FACT, FOLLOWING THE PESETA DEVALUATION, IT ENDED A GLOBAL TARIFF SUR-CHARGE AND MORE RECENTLY LOWERED TAXES ON IMPORTED

FISH IN ORDER TO DRIVE PRICES DOWN BY INCREASING SUPPLY. LAST BUT NOT LEAST, ECONOMICALLY OR POLITICALLY THE GOVERNMENT IS CONSIDERING DEMANDS FROM FREE TRADE UNIONS WHICH WANT TO STRENGTHEN WORKERS RIGHTS AND HAVE PLANT ELECTIONS (NOW SCHEDULED TO BE HELD BY NOVEMBER 15) BEFORE THEY DISCUSS POSSIBLE COOPERATION ON THE GOVERNMENT'S ECONOMIC RECOVERY PROGRAM)

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8. COMMENT WE WILL SOON KNOW WHAT NEW ACTIONS THE GOVERNMENT IS PREPARED TO TAKE, BUT, AT THIS WRITING, THE MEASURES ARE EXPECTED TO BE IN LINE WITH THE GOVERNMENT'S TWO-FOLD JULY PROGRAM OF STABILIZATION AND STRUCTURAL REFORM. A RELATED AND IMPORTANT QUESTION WILL BE PRESENTED. IF PRIME MINISTER SUAREZ DOES IN FACT COMMIT HIMSELF FULLY TO BACKING THE PROGRAM AND HIS ECONOMIC TEAM, THE CHANCES OF SUCCESS OF THE PROGRAM WILL BE SUBSTANTIALLY INCREASED. EATON

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